

NONDEEDED VOTING TIMESHARE MEMBERSHIP COMPARED TO DEEDED FEE

John Rogers Burk; ARDA Roundtable, April 19, 1998

- I. WHAT IS OWNERSHIP? "**OWNERSHIP**" of property includes several material elements:
 - A. Right-to-use.
 - B. Power to decide: how to use, how to manage, whether to sell, encumber or rent, and whether to rebuild if destroyed.
 - C. Right to receive the proceeds from destruction, sale or rent.
 - D. Right to exclude others.
 - E. Responsibility for maintenance and repairs.
 - F. Power during life or at death to designate a new "owner."

- II. IS REAL ESTATE "TITLE" RELEVANT TO **OWNERSHIP**? No; what is relevant is whether the elements of **OWNERSHIP** are granted and protected.
 - A. "Title" to the property can be held in a trust for the benefit of the beneficial owners (beneficiaries), or it can be held by a nonprofit corporation of which all of the "owners" are voting members.
 - B. Legal title is merely a fiction (but still carries the disadvantages) if the real elements of **OWNERSHIP** are materially restricted, subject to conditions, or may be canceled by the developer or club without the consent of the "owner."

- III. WHAT ARE THE DISADVANTAGES OF A DEEDED INTEREST?
 - A. Direct personal liability of the person or entity which holds legal title.
 - B. The time, cost and difficulties of foreclosure.
 - C. Ancillary (foreign) probate when an out-of-state owner dies.
 - D. Clearing title upon condemnation, sale, or substituting another resort or unit(s).
 - E. Individual assessment of property taxes.
 - F. Delays in recording.

- IV. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO PURCHASERS?
 - A. Traditional expectation of appreciation in value from "owning land."
 - B. Traditional expectation that a "deed" is permanent.
 - C. Substantial restrictions and conditions on **OWNERSHIP** and rights to cancel and reconvey may be buried in the documents. See II.B above.
 - D. The disadvantages of holding legal title are not disclosed.

- V. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO THE DEVELOPER AND LENDER?
 - A. Believing there won't be a securities law violation in the grant of a fee interest.
 - B. Believing the Windrifter (lease) income tax consequences won't apply.
 - C. The developer may "bootstrap" itself into unnecessarily burdensome regulatory requirements.
 - D. Thinking that deeded interests sell better than nondeeded interests.
 - E. Thinking that nondeeded interests cannot be financed.
 - F. Assuming that state and federal statutes will not apply if the statutes are based on the sale of "services."

- VI. HOW DO YOU CONTROL INVENTORY IN A NONDEEDED PROGRAM? The same way you control inventory in a deeded program - - someone has to reliably keep track of it.
- A. A County Recorder normally does not monitor the accumulated percentages of undivided interests sold in a unit or project.
 - B. An independent escrow company can only close sales based on available interests established by recorded documents.
- VII. DOES SELLING A DEEDED FEE INTEREST PROTECT YOU AGAINST SECURITIES LAW VIOLATIONS? No
- A. A security is the expectation of profit based on the efforts of others. In the leading case where the U.S. Supreme Court established that definition, the seller was giving a warranty deed to real property, but the main motivation and marketing thrust was expecting a profit from the sale of oranges by the seller/manager of the property.
 - B. If the purchase price or obligation is collected before title and/or promised improvements can be delivered, the purchase money may be "at risk," and in California, Michigan and a few other states you may be guilty of selling a security, whether the interest is deeded or not.
- VIII. WHAT IS THE REAL ISSUE IN THE WINDRIFTER INCOME TAX MEMORANDUM, WHICH IS USUALLY OVERLOOKED? "Whether the seller [promoter] transferred to the buyer [member] all the benefits and burdens of ownership." See I above. Conclusion: Promoter "never parted with the burdens and benefits of ownership." CCH "IRS Letter Ruling Reports," 30 Sep 1977, 7803005.
- A. **OWNERSHIP** title was retained by the promoter because the property reverted to the promoter upon expiration of the 40-year membership.
 - B. Members had no right to extend or renew.
 - C. The promoter locked itself in as sole manager of the project.
 - D. If the project was destroyed the insurance proceeds went only to the promoter.
 - E. Full price was paid in the year of sale.
 - F. Promoter was responsible for repairs or rebuilding.
 - G. Memberships were subordinate to any later financing arranged by promoter.
- IX. WHAT CAN YOU DO TO OVERCOME WINDRIFTER INCOME TAX CONSEQUENCES?
(Consult a qualified tax advisor, but generally:)
- A. Provide a term greater than 30 years, and
 - B. Turn over management to the "owners," and
 - C. Prorate the proceeds from destruction, condemnation or sale between the promoter and the owners based on the remaining term of the membership and the proportion of unsold memberships. OR
 - D. Sell a perpetual membership, whether deeded or based on a membership, and
 - E. Transfer the material elements of **OWNERSHIP**. See I and VIII above.
- X. WILL LENDERS LOAN ON A NONDEEDED VACATION PRODUCT? Yes; the same concerns exist and can be satisfied in a deeded fee, deeded right-to-use (including lease), and nondeeded vacation product.
- A. The experience and track record of the developer and its team.
 - B. A legal structure based on a recognized body of law.
 - C. A legal and practical mechanism for controlling inventory.
 - D. A legal and practical mechanism for insuring title to the membership and protection and priority of the security interest in the membership.
 - E. Assurance that the individual purchasers will receive what they are promised.

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